
IOWA UTILITIES BOARD
Energy Section

Docket No.: RPU-2014-0002
Utility: MidAmerican Energy Company
Memo Date: January 29, 2015

TO: The Board

FROM: Dan Fritz, Leslie Cleveland, Bob LaRocca, Ellen Shaw, Gary Stump, Mack Thompson, Jane Whetstone, Venkata Bujimalla

SUBJECT: Staff Analysis of MidAmerican Petition for Limited Reconsideration

I. Background - Petition

On January 20, 2015, the Board issued an Order Approving Settlement with Modifications in Docket No. RPU-2014-0002. The Order established advanced ratemaking principles for the Wind IX project. On January 22, 2015, MidAmerican Energy Company (MidAmerican) filed a Petition for Limited Reconsideration (Petition). On January 23, 2015, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed a response.

In its Petition MidAmerican accepts all ratemaking principles included in the Board's January 20, 2015, Order except for the following:

Upon completion of at least 50 MW of the Wind IX project and in addition to all other benefits that will flow to customers, prior to a future rate case customers will receive \$2 million per year in energy adjustment clause credits.

MidAmerican argues that the Board's Order provides no evidence demonstrating why the Settlement does not provide adequate balance between customers and ratepayers. In addition, MidAmerican argues that no discussion was provided to demonstrate that the inclusion of a customer credit in the Wind VIII case supports the use of such a credit in this case.

MidAmerican argues that customers will benefit through a reduction in fuel costs without bearing any of the project's capital costs, depreciation expenses, and operating costs until the next rate case. MidAmerican also cites testimony estimating these customer benefits for the first ten years at \$93.5 million and \$461.7 million over the 30-year life of the plant.

MidAmerican notes that the Order requires it to pass through the \$2 million credit even in years when MidAmerican's earnings do not meet the authorized return on equity (ROE) trigger for revenue sharing. MidAmerican says the Order does not explain the basis for this requirement. MidAmerican acknowledges the statement in the Order that the proposed settlement does not represent a reasonable balance of risk and rewards; MidAmerican characterizes the statement as conclusory and unsupported by discussion of the evidentiary record. MidAmerican acknowledges that the gold memo contains analytical graphs that address customer impacts from the settlement, but complains that "virtually the entire content of such analysis is redacted." (Petition, p. 4, n. 4.)

MidAmerican presents estimates of its ROE and indicates that it will not move forward with the project due to the credit.

MidAmerican requests that the customer credit ratemaking principle be eliminated. In the alternative MidAmerican proposes that it be allowed to incorporate the customer credit into the revenue sharing mechanism. MidAmerican proposes that the first \$2 million of revenue sharing (assuming earnings exceed the revenue sharing trigger by at least that amount) be credited 100 percent to customers as a reduction to rate base. Any sharing that occurs after the \$2 million would be divided 80/20 with 80 percent going to the customer until the 100 percent threshold is crossed. In its response OCA supported MidAmerican's proposed alternative.

II. Legal Standards

Iowa Code § 476.12 provides that when an application for rehearing is filed, the Board has 30 days to grant or refuse the application. However, MidAmerican has informed the Board that it has extended the deadline for making significant financial commitments to project vendors only to Friday, February 13, 2015, so the Board should act on the Application no later than Thursday, February 12, 2015. (Notice of Extension of Deadlines filed January 28, 2015.)

In terms of the merits of the Application, ultimately the Board is to specify reasonable ratemaking principles that will apply to Wind IX if MidAmerican proceeds with the construction of the facility. (Iowa Code § 476.53.) The ratemaking principles must attract the development of a sufficient quantity of electric generating facilities in Iowa in a manner that is cost-effective. (Id.) As applied to this project, it may be worth noting that Wind IX is not required in order to provide reliable service to MidAmerican's customers, i.e., it is not necessary to have Wind IX in order to have "electric power generating...facilities...in sufficient quantity to ensure reliable electric service to Iowa consumers..." (§476.53(1).)

III. Analysis

Partial Acceptance of Ratemaking Principles

In its Petition MidAmerican states that it accepts all of the ratemaking principles in the Board's Order other than the customer credit principle. After the rehearing order (assuming there is no court appeal) MidAmerican will have to decide whether to accept or reject the entire ratemaking principles package. Iowa Code section 476.53(3)f. Pragmatically, MidAmerican could still accept the entire package of principles, decide not to pursue the project, and file for cost recovery under the abandonment principle.¹

Alleged Lack of Evidence or Analysis to Support the Order

MidAmerican argues that the Order does not contain sufficient evidence or analysis to justify the nature and amount of the Customer Credit. (Application at p. 3.) The fact is that it was MidAmerican's own assertions that certain information is confidential that caused the Order to be less detailed than it might have been. In order to provide that detail to the Board, this memorandum contains significant amounts of confidential information. Whatever the Board's decision on rehearing might be, staff believes it will be possible to write an order using only public information, and characterizations or descriptions of the confidential information, so that the resulting order will provide a sufficiently detailed explanation of the basis for the Board's decision.

If, however, it is necessary to use some of the actual confidential information in the Board's Order, then MidAmerican will have to be notified of the anticipated release of the information and given the opportunity to seek a court order preventing release, pursuant to 199 Iowa Admin. Code 1.9. Normally, the party that claims the information is confidential has two weeks to at least start the process of obtaining that court order, but in light of MidAmerican's self imposed looming deadlines staff believes MidAmerican would make a decision regarding release of the information more quickly than that.

If it becomes necessary to go down this path, MidAmerican will either agree to the release of the information or seek a court order. It is possible that MidAmerican will agree to make the information public; for example, some of the information is claimed to be confidential in order to preserve MidAmerican's negotiating position with vendors; to the extent that MidAmerican has concluded its negotiations with some or all of those vendors, MidAmerican may no longer need that confidentiality.

¹ If it did so, MidAmerican would be required to prove the prudence of the expenditures.

If MidAmerican chooses to seek a court order preventing release of the information, then it will likely take at least a few weeks, and perhaps longer, to receive a final ruling from the court. This may very well render the entire matter moot, if MidAmerican's February 12, 2015, deadline is a firm one.

Basis for the Customer Credit

MidAmerican argues that the Order does not cite evidence or analysis justifying the nature and amount of the customer credit.² Nearly all of the economic analysis provided by MidAmerican was filed as confidential. As a result the Board limited the information cited in the Order to protect the information that MidAmerican claimed to be confidential. Pages 4 through 10 of staff's post hearing analysis memo³ provide a detailed summary of the economic information that MidAmerican filed.⁴

In its Petition MidAmerican refers to the "cost-free energy Iowa customers will receive without incurring cost for MidAmerican's Wind IX capital costs, depreciation expenses, and other operating and maintenance expenses until a future rate case."⁵ This statement fails to acknowledge that prior to the next rate case the effect of including Wind IX in the revenue sharing calculation will offset a significant portion of the "cost-free energy" benefit. It also ignores the fact that MidAmerican's existing base rates include recovery of book depreciation, return on investment in plant, and O&M expense on the plants whose generation the Wind IX project is replacing in the plant dispatch. Staff's memo, and the Board's Order, relied on the economic information provided by MidAmerican and attempted to account for, and balance, all of the costs, benefits, and risks associated with Wind IX.

As noted on page 10 of staff's post hearing memo, per the provisions of the Settlement, MidAmerican's risk appears to be well hedged. The PTC benefits that will flow to MidAmerican prior to the next rate case appear to be relatively certain (Tr. 126-127), Wind IX will be included in the revenue sharing calculation [REDACTED] and MidAmerican has the option of initiating a rate case if the project becomes too much of a drag on earnings. On the other hand, customer benefits are projected to vary significantly over time, are negative at least part of the time, and are far less certain. Customer benefits over the life of the project could be negative if the assumptions used in MidAmerican's economic models turn out to be overly optimistic.

² Petition page 3.

³ Dated January 12, 2015.

⁴ That analysis is not repeated in detail here. However, some key parts of the memo are included in this summary.

⁵ Petition pages 1-2.

As a result of all these factors, the balance of risks and rewards under the Settlement is unreasonably skewed in MidAmerican's favor. The ratemaking principles in the Settlement would place significant risk on customers, while MidAmerican's risks are much less. However, MidAmerican's Confidential Appendix A (filed with the Petition), projects that under the Settlement, MidAmerican would reap about 75 percent of the benefits over the first ten years. Under the ratemaking principles approved by the Board, with the additional customer credit, the sharing of benefits is much closer to 50 percent for each side.

The Board's decision to provide customers an additional \$2 million per year of benefit prior to the next rate case will increase the likelihood that the project will be beneficial to customers over its depreciable life. The Board judged that the additional \$2 million was needed to produce customer benefits commensurate with the risk that customers will bear. No new information has been provided in the Petition to cause staff to change its analysis regarding customer risks or benefits.

Impact of the Credit on MidAmerican's Earnings

MidAmerican argues that the Board's Order did not assess the impact of the customer credit on MidAmerican's ability to recover the allowed ROE pursuant to the applicable ratemaking principle.⁶ Staff notes that the authorized ROE applies once the project is added to rate base in a future rate case. Prior to that time the authorized ROE is not applicable to the Wind IX project. Per the Settlement and the Board's Order, MidAmerican has the ability to decide when it will file a rate case to add the project to rate base (subject to the Board's authority to initiate a rate case under chapter 476)..

The Board's customer credit modification may result in shareholder returns that MidAmerican deems insufficient and MidAmerican may choose to not proceed with the project, as permitted by § 476.53(3)"f"(1). MidAmerican provided a summary of customer and MidAmerican benefits associated with Wind IX, both with and without the \$2 million customer credit.⁷ MidAmerican indicates that its ROE for the first ten years of the project would average [REDACTED] without the credit and [REDACTED] with the credit. Staff notes that MidAmerican's projected ROE is positive in all years both with and without the \$2 million credit while customer benefits are negative in some years even with the credit. Staff notes that the ROE numbers provided by MidAmerican are based on projected net earnings.⁸

⁶ Petition page 4.

⁷ Confidential Appendix A of the Petition.

⁸ Staff's experience is that typically project analysis returns based on free cash flows are often significantly higher than the returns based on net earnings.

[REDACTED] The Board's intent in ordering the additional \$2 million annual payment is to bring the benefits to a more equitable level between ratepayers and shareholders.

Staff has calculated that reducing earnings by \$2 million to account for the additional payout would reduce MidAmerican's total company post revenue sharing ROE by approximately 5-7 basis points.⁹

MidAmerican indicates that it will not move forward with the project because of the credit.¹⁰ Staff understands that MidAmerican may not find the project returns acceptable if the credit is upheld; however staff cannot recommend that the Board approve a project that is profitable for MidAmerican but unlikely to provide customer benefits commensurate with the risk that customers would be bearing.

Nothing in the record indicates that failure to pursue the project would jeopardize reliability.

MidAmerican's Alternative Proposal

MidAmerican believes the annual \$2 million credit should be removed from the Order. In the alternative, if the credit is not removed, MidAmerican proposes that the \$2 million be incorporated into the revenue sharing calculation. The first \$2 million of revenue sharing would be credited 100 percent to customers as a reduction to rate base, with any additional amounts credited using the split as determined in Docket No. RPU-2013-0004. The Consumer Advocate supports this alternative.

MidAmerican did not provide information similar to that provided in Confidential Appendix A to illustrate the customer and ROE impact of its proposed alternative. Staff estimates that at best customers will benefit by \$400,000 per year¹¹ under MidAmerican's proposed alternative instead of the \$2 million that the Board identified. Also, because under MidAmerican's alternative the benefit is used to reduce rate base, customers would not realize a benefit until a future rate case.

⁹ Staff used the excel spreadsheet MidAmerican filed January 31, 2014, to support its revenue sharing calculation (Docket No. RPU-03-1).

¹⁰ MidAmerican refers to not moving forward with the Adams County site which would host all but three of the Wind IX turbines. (Petition page 4)

¹¹ Under MidAmerican's alternative proposal 100 percent of the first \$2 million of earnings above the sharing threshold would go to customers instead of 80 percent. The 20 percent difference equates to \$400,000.

Staff Alternative

MidAmerican expressed a concern that the Board's Order requires the \$2 million per year credit regardless of its ROE in each year. As an alternative to address this concern, the Board could modify its Order to tie the credit payment to MidAmerican's earnings level. For example, in the event that MidAmerican's earnings are below 11 percent, MidAmerican would not be required to make the \$2 million payment through the EAC. In the event that earnings are not enough above the 11 percent threshold to cover the entire \$2 million, MidAmerican would only be required to pay the portion of the \$2 million that is above the 11 percent threshold. If MidAmerican's earnings are more than \$2 million above the threshold the entire \$2 million will be paid back through the EAC.¹²

Table 1 below illustrates the customer impacts under the various customer credit alternatives.

Table 1 - Comparison of Customer Credit Alternatives

Scenario	Customer Impact			
	No Customer Credit	Per Order	Staff Alternative	MidAmerican Alternative
Presharing ROE below 11%	\$0	\$2 million	\$0	\$0
Presharing ROE above 11% by \$1 million	\$0.8 million from revenue sharing	\$2.8 million (\$800,000 from revenue sharing plus \$2 million)	\$1 million	\$1 million
Presharing ROE above 11% by \$2 million	\$1.6 million from revenue sharing	\$3.6 million (\$1.6 million from revenue sharing plus \$2 million)	\$2 million	\$2 million
Presharing ROE above 11% by \$5 million	\$4 million from revenue sharing	\$6 million (\$4 million from revenue sharing plus \$2 million)	\$6 million (\$4 million from revenue sharing plus \$2 million)	\$4.4 million (100% of the first \$2 million plus 80% of \$3 million)

Revenue Sharing

The Board could take the view that MidAmerican has made a good case for the benefits of the project but the revenue sharing mechanism is not functioning as intended, namely the revenue sharing mechanism does not allow the Board to set a reasonable balance between customer and company interests. The information provided by MidAmerican indicates that for the Wind IX project customers would be better off under traditional

¹² Staff notes that in response to Question 3 in the Board's December 11, 2014, Order, MidAmerican provided estimated total earnings levels for the years 2015-2024. The estimates that were provided by MidAmerican were post sharing totals and ranged from [REDACTED] if Wind IX is included. MidAmerican has indicated that those ROE estimates are post-sharing levels and not the full earnings for the year. (Tr. 128) Since the revenue sharing begins at 11 percent and provides 80 percent to the customer on earnings from 11-15 and 100 percent above 15, staff calculates that over the ten years, in the analysis provided by MidAmerican, MidAmerican estimates that its pre shared ROE with Wind IX will [REDACTED] each of the ten years and would reach [REDACTED] in the latter years.

rate making¹³ and under traditional rate making MidAmerican would benefit from an authorized ROE from the beginning of the project.

The Board may want to convey this concern in the Order on rehearing and potentially take this issue up in a future docket.

IV. Recommendation

Option 1 - Schedule a briefing/decision meeting so the Board and staff can discuss the options.

Option 2 - Direct General Counsel to draft for the Board's consideration an Order consistent with the following option.

Option 2A Affirm the Order and provide information to support the prior decision.

Option 2B Amend the Order by tying the credit payment to MidAmerican's earnings level.

Option 2C Amend the Order by accepting the alternative presented by MidAmerican.

Option 2D Amend the Order by deleting the customer credit ratemaking principle.

RECOMMENDATION APPROVED

IOWA UTILITIES BOARD

Option 2A

/s/ Elizabeth S. Jacobs 1-29-15

Date

Referencing MEC's timelines, option 2A moves this thing along. The order should cite back to previous wind (VIII and earlier) cases, the precedent established by MEC in spreading risk and revenue-sharing. ESJ

RECOMMENDATION APPROVED

IOWA UTILITIES BOARD

Option 2A

/s/ Nick Wagner 1/30/15

Date

RECOMMENDATION APPROVED

IOWA UTILITIES BOARD

Option 2A

/s/ Sheila K. Tipton 2/2/2015

Date

/dwf

¹³ See staff's Post Hearing Analysis memo page 7.